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THE TAXATION OF DIVIDENDS

Recent developments in the stock market are illustrating some propositions of very considerable theoretical interest, and of more than usual significance in the field of practical economics.

It has long been recognized in the everyday business world that the value of any income-earning property rests not upon cost but upon earning power. This truth is now belatedly taking its position as a commonplace in theoretical discussion. It is coming to be recognized that cost gets into the case, if at all, only by way of affecting supply. It follows that the values of all corporate securities, railroad or other, and the values of all lands or other intermediates of production are simply the present worth of more or less confidently expected future earnings.

This principle has a very definite bearing on some problems of taxation. Especially is this true in the case of the common stocks of railway corporations. If it may be assumed, for purposes of the argument, that the bonds and preferred stocks of American railroads are, in most cases and on the average, sufficient in volume to cover the investment costs of creating the plants and establishing the businesses, it must follow, if the doctrine stated above is accepted, that the common stocks carry a market value representative of nothing else than the present worth of the hope of excess income to be secured. The problem in this case then is, how can the machinery of taxation be made to serve in securing to the public the incomes accruing upon these stocks.

Precisely this problem presented itself to Bastable in connection with the theory of the single tax upon land, and is, indeed, a problem and a difficulty to which the single-tax advocates may well address their most serious attention; but equally obviously is it a problem having much more important bearings. Bastable observes:

Weighty is the fact that with a system of private ownership and a developed economic organization the titles to these "unearned gains" are in a constant process of transfer, and future prices are estimated in the prices given. The anticipated future movement of rent is registered in the price of land. Premiums on shares measure the gains from [expected] speculation or monopoly. Justice could therefore be attained only by taxing such increase immediately on its existence being noticed, an entirely hopeless endeavor.

But "such increase" of what? The earning power—the actually accruing income from the property or business? But—as is pointed out—these anticipated earnings were long ago capitalized

into market values, and have since undergone indefinite transfer. The difficulty is precisely parallel to that of confiscating the existing land values.

But if by "such increase" is meant the increased market values derivative from the substance of things hoped for, and if it be intended that taxation should forthwith step in to appropriate these increases, there is the difficulty that upon this assumption these increases will never manifest themselves; if the certainty exists that when these generous revenues shall actually accrue, the state will bestir itself to intercept them, market values can never rise in foreshadowing and announcement of the coming event.

There is, indeed, a curious circuitry in the situation; only upon the assumption that these future excess revenues will never be seized can there now be any market value to be taxed. Still more illogical is the attempt to tax these future excess revenues *as such* before they are collected; in such case, not only will there be no market values to express them, but, the tax payment being made at present as a cash outlay, an interest rate will have to be computed upon it—a reduction from the residuum of present worth attaching to the security after its value has been scaled down by the cancellation of all its "unearned-increment" hopes.

That is to say, if taxation were adopted as a remedial device for the case, the very uncovering of the prospective gain through a present market value would involve the result that these gains could never come to be enjoyed. Thus market values can never disclose the iniquities in question excepting upon the assumption that no remedial action is to be undertaken. And if, contrary to the market-registered expectation, there is finally applied a remedy, this remedy must work as the sudden confiscation of market values long generally traded in but now lodged deflated in the hands of those investors least shrewd of political forecast.

If, however, doubt exist as to the future policy to be governmentally adopted, stock values become nothing more or other than a great game and gamble upon this issue. When faith in public drowsiness flourishes, or when confidence waxes in the possibility of controlling the intermediaries between public opinion and its legislative expression, stocks will be value-strong in the prospect of future high returns. When, however, turbulence of public opinion becomes especially marked, or some truculent executive gets especially strenuous, there befalls a stock panic, and, if conditions are

favorable, direful secondary effects and reactions. And all these phenomena might present themselves entirely free of complication with tightly stretched credit conditions.

Not only, then, is the tax impossible till the time has passed to move toward remedy, but the most convinced advocates of the tax plan impliedly give away their case by the substantial admission that at best the tax is in their view only a very inadequate remedy, since any tax levied in general proportion to market values can avail to cancel only a small fraction of the capitalized unearned increment. And, as we have seen, did the tax promise to be more than this and to be adequate to the problem, there would be no market values to be taxed. It is worth recalling in illustration of the view presented that four years ago Steel Common had fallen to ten dollars a share despite the fact that it was paying a current dividend of 4 per cent.

Nothing then is possible as solution of the unearned-increment problem excepting to take such measures *in advance* as shall forbid either as capitalized present worth or as later collectible revenues the emergence of the unearned increments in question. The methods must be entirely anticipatory and preventive, whether by the regulation of rates, or by sliding scales of franchise charge, or even by the still more drastic—and possibly less effective or less practicable—devices of radicalism.

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